SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1933

No. 212

WILLIAM R. THORSEN, PETITIONER,

vs.

GUY T. HELVERING, COMMISSIONER OF INTERNAL REVENUE

ON WRIT OF CERTIORARI TO THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT

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JUDD & DETWEILER (INC.), PRINTERS, WASHINGTON, D. C., OCTOBER 26, 1933

[1*] DOCKET No. 38,095.

WILLIAM R. THORSEN

vs.

COMMISSIONER OF INT. REV.

APPEARANCES.

For Taxpayer: EDWIN H. CASSELS, Esq.
ANDREW L. CAMPBELL, C.P.A.

For Commissioner: W. F. GIBBS, Esq.
HAROLD ALLEN, Esq.
WILLIS R. LANSFORD, Esq.
H. D. THOMAS, Esq.

DOCKET ENTRIES.

1928.

May 2—Petition received and filed. Taxpayer notified. (Fee paid.)

May 3—Copy of petition served on General Counsel.

July 2—Answer filed by G. C.

July 14—Copy of answer served on taxpayer. General calendar.

1930.

Aug. 18—Hearing set Oct. 15, 1930.

Oct. 13—Motion to consolidate with 34,131 for hearing at later date filed by taxpayer.

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*Page-number appearing at the top of page of original certified Transcript of Record.

1930.

Oct. 15—Hearing had before John E. Murdock, Div. 3, on merits and motion to Dkt. 34,131. Continued to Oct. 30, 1930. No action taken on motion for consolidation.

Oct. 15—Order placing proceeding on day calendar of Oct. 30, 1930, for hearing on the merits entered.

Oct. 30—Hearing had before Herbert F. Seawell, Div. 4 on merits. Submitted stipulation of facts filed. Briefs due in 60 days.

Nov. 12—Transcript of hearing of Oct. 30, 1930, filed.

Dec. 27—Brief filed by taxpayer.

Dec. 29—Brief filed by G. C.

1931.

June 12—Findings of fact and opinion rendered Herbert F. Seawell, Div. 4. Judgment will be entered under Rule 50.

June 29—Order that pursuant to Section 601 (b) of the Revenue Act of 1928, the division report of June 2, 1931, promulgated June 12, 1931, be reviewed by the Board, entered.

Aug. 6—Stipulation to file supplemental brief filed.

Aug. 7—Order granting petitioner and Commissioner 30 days to file supplemental briefs entered.

Aug. 8—Supplemental memo. brief filed by taxpayer.

Sept. 3—Supplemental brief filed by G. C.

1931.

Oct. 27—Findings of fact and opinion rendered, Mr. Seawell, Div. 4. Judgment will be entered under rule 50.

Nov. 23—Notice of settlement filed by G. C.

Dec. 1—Hearing set Dec. 16, 1931.

Dec. 16—Consent to settlement filed by taxpayer.

Dec. 16—Hearing had before Mr. Smith on settlement under Rule 50. Referred to Mr. Seawell for decision.

Dec. 19—Decision entered, Herbert F. Seawell, Div. 4.

[2] Docket No. 38,095.

1932.

Apr. 16—Petition for review by U. S. Cir. Ct. of Ap. (9) with assignments of error filed by taxpayer.

Apr. 16—Praecipe filed.

Apr. 16—Certificate of service of petition and praecipe filed.

Apr. 23—Proof of service of petition and praecipe filed.

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[3] Filed May 2, 1928.

United States Board of Tax Appeals.

DOCKET No. 38,095.

WILLIAM R. THORSEN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

PETITION.

The above-named petitioner hereby petitions for a redetermination of the deficiency set forth by the Commissioner of Internal Revenue in his notice of deficiency (IT:CR:G-4:60-D:GC) dated March 6, 1928, and as a basis of his petition alleges as follows:

(1) Petitioner is an individual, residing at 2307 Piedmont Avenue Berkeley, California, and having his principal office at #1107 Crocker-First National Bank Building, San Francisco, California.

(2) On or about March 6, 1928, the Commissioner of Internal Revenue at Washington, D. C., mailed to the petitioner at the above address in San Francisco, California, a letter and notice of deficiency claiming a deficiency in tax in the amount of $36,720.96 for the taxable year 1923. A copy of said notice of deficiency is hereto appended marked Exhibit "A."

[4] (3) The taxes in controversy are income taxes for the year 1923 in the amount of $36,720.96.

(4) The determination of tax set forth in said notice of deficiency is based upon the following errors:

I.

The Commissioner of Internal Revenue erred in his determination that the taxable dividends received by the petitioner from the West Side Lumber Company during the calendar year 1923 amounted to $278,505.90.

II.

The Commissioner of Internal Revenue erred in finding that the taxable dividends reported by the petitioner in his 1923 tax return as having been received from the West Side Lumber Company during 1923 amounted to $181,812.

[5] III.

The Commissioner of Internal Revenue erred in increasing the taxable income of the petitioner for the year 1923 by adding thereto the sum of $96,693.90, which amount was arrived at by the Commissioner as follows:

"Taxable dividends from the West Side Lumber Company—

Corrected	$278,505.90
Reported on Return	181,812.00
Addition	$96,693.90

Of the total dividends received by you during this year 25.05% have been allocated as taxable. Since you received $1,111,800 the amount taxable on your return is $278,505.90."

IV.

The Commissioner of Internal Revenue erred in holding that 25.05% of the total dividends received by the petitioner during the year 1923 from the West Side Lumber Company were taxable dividends under the provisions of Section 201 of the Revenue Act of 1921, said allocation having been determined by the Commissioner as follows:

Dividend	February 12, 1923	$ 10 per share	100.00%	taxable	$10.00
"	April 14, "	340 "	22.85	"	77.69
	Total	$350 per share	25.05%	"	$87.69

[6] V.

The Commissioner of Internal Revenue erred in finding that the total dividends received by the petitioner from the West Side Lumber Company during the year 1923 amounted to $1,111,800, whereas the taxpayer did receive and report the receipt of dividends from that source as follows:

	Total Dividends Received.	Taxable Dividends Reported.
Dividends from the West Side Lumber Company:		
February 12, 1923—3,270 shares @ $ 10	$ 32,700.00	32,700.00
April 14, " —3,270 " @ 340	1,111,800.00	181,812.00
	$1,144,500.00	214,512.00

VI.

The Commissioner of Internal Revenue erred in finding that 22.85% of the dividend paid by the West Side Lumber Company on April 14, 1923, was paid out of surplus accumulated by that Company subsequent to March 1, 1913, and that 22.85% of that dividend was therefore taxable to the recipients.

VII.

The Commissioner of Internal Revenue erred in finding that only 77.15% of the dividend paid by the West Side Lumber Company on April 14, 1923, was paid out of surplus accumulated by that company prior to March 1, 1913, and that only 77.15% of that dividend was therefore nontaxable.

[7] VIII.

The Commissioner of Internal Revenue erred in determining that the surplus of the West Side Lumber Company accumulated subsequent to March 1, 1913, and available for dividends on April 14, 1923, amounted to $1,165,282.92, or 22.85% of the dividend of $5,100,000 then paid, which amount was arrived at by the Commissioner as follows:

Surplus of West Side Lumber Company.

Surplus, March 1, 1913.....			$4,332,684.78
Subsequent Earnings—			
Year ending February 28,	1914.....		$ 4,594.62
" " "	1915	(Loss $193,139.67)	
" " "	1916	(Loss $211,707.32)	
" " "	1917		60,495.56
" " "	1918		57,901.55
" " "	1919		208,737.34
" " "	1920		543,490.33
" " "	1921		640,837.43
" " "	1922		182,954.63
" " "	1923		718,858.29
" " "	1924	up to April 14, 1923	
44/366th of $311,209.54			37,413.17
			$2,455,282.92

Less:			
Dividends Paid—			
Year ending Feb. 28, 1918	15,000 shs. @ $6....	$ 90,000.00	
" " " 1920	15,000 " @ 5....	75,000.00	
" " " 1921	15,000 " @ 25....	375,000.00	
" " " 1922	15,000 " @ 20....	300,000.00	
Sept. 15, 1922	15,000 " @ 10....	150,000.00	
Dec. 18 "	15,000 " @ 10....	150,000.00	
Feb. 12, 1928	15,000 " @ 10....	150,000.00	
			1,290,000.00
Surplus available for dividends as at April 14, 1923 (Taxable)		22.85%	1,165,282.92
Amount distributed out of Surplus accumulated prior to March 1, 1913 (Non-Taxable)		77.15	3,934.717.08
Total dividend declared and paid on April 14, 1923— 15,000 shares at $340		100.00%	$5,100,000.00

[8] IX.

The Commissioner of Internal Revenue erred in determining that the taxable portion of the dividend paid by the West Side Lumber Company on April 14, 1923, amounted to $1,165,282.92 or 22.85% of the dividend then paid (Item VIII, *supra*) by specifically omitting from his calculation of surplus accumulated by that company subsequent to March 1, 1913, all of the earnings received, expenses paid, and depreciation sustained by the corporation during the two fiscal years ending February 28, 1915, and February 29, 1916, in the following amounts:

	Year ending Feb. 28, 1915	Year ending Feb. 29, 1916
Sales and Other Income	$675,738.85	646,732.42
Less:		
Cost and Expenses	$720,725.62	717,617.75
Depreciation and Depletion	148,152.90	140,821.99
	$868,878.52	858,439.74
Net Loss, carried to Surplus	$193,139.67	211,707.32

[9] X.

The Commissioner of Internal Revenue erred in determining that the nontaxable portion of the dividend paid by the West Side Lumber Company on April 14, 1923, amounted to $3,934,717.08 or 77.15% of the total dividend then paid (Item VIII, *supra*) by specifically deducting from the surplus accumulated by the company prior to March 1, 1913, the losses and depreciation sustained by the company during the two fiscal years ending February 28, 1915, and February 29, 1916, amounting to $193,139.67 and $211,707.32, respectively (Item IX, *supra*), thereby denying to the corporation and its stockholders the statutory right to recover, either through depreciation allowances or by nontaxable distribution, all of the surplus of the corporation which existed on March 1, 1913, and which amounted to $4,[illegible]684.78.

XI.

The Commissioner of Internal Revenue erred in holding that $1,165,276.92 of the earnings of the West Side Lumber Company subsequent to March 1, 1913, were available for dividends on April 14, 1923, when, as a matter of fact, at least $404,846.99 of the undistributed earnings subsequent to February 29, 1916, has been used to make good the losses and depreciation sustained by the company during the two fiscal years ending February 28, 1915, and February 29, 1916 (Item IX, *supra*).

[10] XII.

The commissioner of Internal Revenue erred in not finding from his computation of the Surplus Ac-

count of the West Side Lumber Company (Item VIII, *supra*):

(a) That the total Surplus of the Company on April 14, 1923 amounted to $5,093,114.71 determined as follows:

Surplus as at March 1, 1913		$4,332,684.78
Subsequent Earnings	$2,455,282.92	
Less: Losses for years 1915 and 1916	404,846.99	
	$2,050,435.93	
Less: Dividends Paid	1,290,000.00	
Accumulated Surplus subsequent to March 1, 1913		760,435.93
Total Surplus as at April 14, 1923		$5,093,120.71

(b) That the Company on April 14, 1923, declared and paid a dividend of $340 per share on its 15,000 shares of Capital Stock outstanding, amounting to $5,100,000.00

(c) That the taxable portion of said dividend declared and paid on

April 14, 1923, out of surplus accumulated subsequent to March 1, 1913, amounted to $760,429.93 or 14.91% of the total distribution.

(d) That the total dividends received by this petitioner from the West Side Lumber Company on April 14, 1923, on his 3,270 shares of Capital Stock amounted to 3,270x$340 or $1,111,800.00

(e) That the taxable portion of said dividends received by this petitioner from the West Side Lumber Company on April 14, 1923, amounted to 14.91% of $1,111,800 or $165,769.38

[11] XIII.

The Commissioner of Internal Revenue erred in computing and proposing to assess a tax against this petitioner based on taxable income determined by including therein taxable dividends from the West Side Lumber Company in the aggregate amount of $278,505.90.

XIV.

The Commissioner of Internal Revenue erred in not finding that there was no deficiency in tax of this petitioner for the year 1923.

[12] XV.

The Commissioner of Internal Revenue erred in not finding that there was an overassessment of tax against this petitioner for the year 1923, determinable as follows:

Net Income reported on return		$189,032.72
Additions:		
(a) Decrease in partnership loss		1,327.99
(b) Decrease in donations		120.00
		$190,480.71
Deductions:		
(c) Decrease in taxable dividends received April 14, 1923, from West Side Lumber Company:		
Reported in return	$181,812.00	
Corrected (Item XI–e, *supra*)	165,769.38	
		16,042.62
Net Taxable Income adjusted		$174,438.09
Total Tax computed on $174,438.09		$ 58,434.66
Less: 25% reduction under the Revenue Act of 1924		14,608.66
Tax Liability		$ 43,826.00
Previously assessed		49,189.52
Overassessment		$ 5,363.52

[13] (5) The facts upon which the petitioner relies as a basis of this proceeding are as follows:

(a)

On or about January 24, 1924, the petitioner filed his income tax return for the taxable year 1923 in which he reported taxable income of $189,-032.72 determined as follows:

Salaries Received		$ 6,000.00
Interest Received		4,267.38
Dividends Received—		
West Side Lumber Company:		
Feb. 12, 1923—3,270 shares @ $10.00	$ 32,700.00	
Apr. 14, 1923—3,270 shares @ $55.60	181,812.00	
Brooklyn Edison Company	2,200.00	
Armour & Company	1,651.81	
Commonwealth Power pany	1,137.35	
Sunset Francis Oil Company	426.36	
Berkeley Bank	40.00	
		219,967.52
		$230,234.90
Deductions—		
Partnership Losses	$10,358.92	
Losses on Sale of Securities, etc.	19,849.01	
Interest Paid	2,371.37	
Taxes Paid	862.88	

Contributions	7,610.00	
Expenses	150.00	
		41,202.18
Net Income reported in return.....		$189,032.72

[14] (b)

The total tax computed by the petitioner for the year 1923 on taxable income of $189,032.72 amounted to $49,189.52, which amount the petitioner paid to the Collector of Internal Revenue, at San Francisco, California, in installments as follows:

Jan. 24, 1924, Paid to Collector	$32,793.02
Sept. 10, 1924, Paid to Collector	8,198.26
Dec. 11, 1924, Paid to Collector	8,198.24
	$49,189.52

(c)

The West Side Lumber Company is a California Corporation organized in 1889. The capital of the Company at March 1, 1913, and at April 14, 1923, was represented by 15,000 shares of capital stock having a par value of $100 each, and a book value as determined by the Commissioner and admitted by the petitioner, as follows:

	Mar. 1, 1913	Apr. 14, 1923
Capital Stock	$1,500,000.00	1,500,000.00
Surplus	4,332,684.78	5,093,120.71
Total Capital	$5,832,684.78	6,593,120.71
Value per share	$ 388.85	439.54

[15] (d)

On April 14, 1923, the West Side Lumber Company declared and paid to its stockholders a dividend of $340 per share on its 15,000 shares of capital stock, said dividends aggregating $5,100,000 and constituting a distribution of the entire surplus of the company, both as to surplus accumulated subsequent to March 1, 1913, and surplus accumulated prior thereto.

(e)

The petitioner owns 3,270 shares of the capital stock of the West Side Lumber Company which he acquired about 1906 and which he continuously owned up to and including April 14, 1923.

(f)

On April 14, 1923, the petitioner received from the West Side Lumber Company a dividend of $340 per share on his 3,270 shares of the capital stock of that company, amounting to $1,111,800.

[16] (g)

The fiscal year of the West Side Lumber Company ends on the last day of February in each year and the surplus of that company as at March 1, 1913, and April 14, 1923, has been computed by the Commissioner and admitted by the taxpayer as follows:

Surplus as at March 1, 1913.....		$4,332,684.78
Subsequent Earnings:		
Year ending February 28, 1914.....	$ 4,594.62	
Year ending February 28, 1915 Loss.....	(193,139.67)	
Year ending February 29, 1916 Loss.....	(211,707.32)	
Year ending February 28, 1917.....	60,495.56	
Year ending February 28, 1918.....	57,901.55	
Year ending February 28, 1919.....	208,737.34	
Year ending February 29, 1920.....	543,490.33	
Year ending February 28, 1921.....	640,837.43	
Year ending February 28, 1922.....	182,954.63	
Year ending February 28, 1923.....	718,858.29	
Year ending February 29, 1924 up to April 14, 1923—44/366ths of $311,209.54..	37,413.17	
		2,050,435.93
		$6,383,120.71

Less:		
Dividends Paid—		
Year ending February 28, 1918	$ 90,000.00	
Year ending February 29, 1920	75,000.00	
Year ending February 28, 1921	375,000.00	
Year ending February 28, 1922	300,000.00	
September 15, 1922	150,000.00	
December 18, 1922	150,000.00	
February 12, 1923	150,000.00	
		1,290,000.00
Surplus at April 14, 1923		$5,093,120.71
Dividend paid April 14, 1923—		
15,000 shares @ $340 per share		$5,100,000.00

[17] (h)

The Commissioner has determined that the surplus of the West Side Lumber Company accumulated subsequent to March 1, 1913, and available for dividends on April 14, 1923, amounted to $1,165,276.92 and that the amount of surplus distributable exempt from tax on April 14, 1923, was $3,934,723.08. In arriving at these amounts the Commissioner has considered that the losses and depreciation sustained by the company during the two years ending February 28, 1915, and February 29, 1916, aggregating $404,846.99 should be deducted from the surplus accumulated prior to March 1, 1913, and not from the surplus accumulated subsequent to March 1, 1913. The taxpayer claims as a matter of fact that at least $404,846.99 of the earnings of the company for years following February 29, 1916, were used to make good the losses and depreciation for the two years ending February 28, 1915, and February 29, 1916, and in support of this contention submits the following facts:

(1) The surplus of the company at March 1, 1913, amounting to $4,332,684.78 was invested in timber and plant and was not in such form that it could be used to pay dividends or furnish working capital.

(2) During the years ending February 28, 1915, and February 29, 1916, the expenses of the company exceeded its income and in order to pay these expenses the company borrowed $700,000 by the issuance and sale of $700,000 First Mortgage 6% Serial Gold Bonds dated September 15, 1915. The

proceeds from sale of these bonds in September, 1915, amounted to $636,000 and such proceeds were used to pay expenses incurred in 1915 and 1916 and for working capital.

[18] (3) Out of the earnings in subsequent years the company paid this indebtedness by the redemption and cancellation of its bonds as follows:

Mar. 15, 1918 Bonds redeemed at maturity	$175,000.00
Sept. 15, 1920 Bonds redeemed at maturity	175,000.00
Feb. 28, 1921 Bonds purchased and retired	116,000.00
Feb. 28, 1922 Bonds purchased and retired	57,000.00
Feb. 28, 1923 Bonds purchased and retired	60,000.00
Mar. 15, 1923 Bonds purchased and retired	117,000.00
	$700,000.00

(i)

The losses and depreciation sustained by the West Side Lumber Company during the two fiscal years ending February 28, 1915, and February 29, 1916, which the Commissioner has deducted from surplus accumulated prior to March 1, 1913, were as follows:

	Year ending Feb 28, 1915	Year ending Feb. 29, 1916
Sales and Other Income	$675,738.85	646,732.42
Less: Costs and Expenses	$720,725.62	717,617.75
Depreciation and Depletion	148,152.90	140,821.99
	$868,878.52	858,439.74
Net Loss, carried to Surplus	$193,139.67	211,707.32

The excess of expenses over income was paid by the company out of funds obtained from the sale of bonds in 1915 and these bonds were thereafter paid out of the income of subsequent years. Depreciation and depletion charges as stated above are the amounts determined and allowed by the Commissioner for the purpose of returning to the company, out of income, the value of its property as of March 1, 1913.

[19] (j)

In filing his original tax return for the year 1923 the petitioner reported taxable dividends received from the West Side Lumber Company in the following amounts:

February 12, 1923—3,270 shares @ $10			$32,700.00
April 14, 1923—3,270 shares @ $340.00		$1,111,800.00	
Less: Nontaxable portion paid out of surplus accumulated prior to March 1, 1913 —3,270 shares @	284.40	929,988.00	
Taxable 3,270 shares @ .....$ 55.60			181,812.00
Taxable dividends from West Side Lumber Company reported by petitioner in original return.....			$214,512.00

Some time after petitioner filed his 1923 return in which he allocated the dividend of April 14, 1923, as above, the Commissioner examined the accounts of the corporation for all years up to February 29, 1924, and determined that the surplus of the company at March 1, 1913, amounted to $4,332,-684.78, and that at April 14, 1923, it amounted to $5,093,120.71, as shown by the computation set forth in Item (g) *supra* which the petitioner accepts as correct.

As a result of the Commissioner's revision of the surplus account of the company the petitioner contends that the dividends which he received in 1923 from the West Side Lumber Company should have been reported as follows:

Feb. 12, 1923—3,270 shares @ $10....		$ 32,700.00
Apr. 14, 1923—3,270 shares @ $340...	$1,111,800.00	
Taxable—14.91%		165,769.38
Total taxable dividends from West Side Lumber Company, as corrected		$198,469.38

[20] (k)

The total tax paid by the petitioner for the year 1923 amounted to $49,189.52 (Item (b) *supra*) whereas it is now his contention that the proper amount of such tax is not more than $43,826 and that instead of a deficiency of $36,720.96 for the year 1923 there was, in fact, an overassessment for that year amounting to $5,363.52 determinable as follows:

Net Income reported on return.....		$189,032.72
Additions:		
(a) Decrease in partnership loss.....		1,327.99
(b) Decrease in donations.....		120.00
		$190,480.00
Deductions:		
(c) Decrease in taxable dividend received during 1923 from the West Side Lumber Company as follows:		
Reported in return (Item a).....	$214,512.00	
Taxable Dividends corrected (Item j).....	198,469.38	
		16,042.62
Net Taxable Income as amended.....		$174,438.09

Total Tax computed on $174,438.09	$ 58,434.66
Less: 25% reduction under the Revenue Act of 1924	14,608.66
Tax Liability	$ 43,826.00
Previously Assessed	49,189.52
Overassessment	$ 5,363.52

[21] WHEREFORE, the petitioner prays that this Board may hear the claims of the petitioner; that it may redetermine the alleged deficiency in such notice of deficiency; that it may direct the Commissioner of Internal Revenue to recompute the tax liability of the petitioner for the year 1923 in conformity with the claims and matters hereinbefore set out; and that it may find that there is no deficiency in the tax returned and paid by this petitioner for the year 1923, but that he has, in fact, paid for the year 1923 a greater tax than was lawfully due from him.

WILLIAM R. THORSEN. (Petitioner.)
WILLIAM R. THORSEN,
1107 Crocker First National Bank Bldg.,
San Francisco, California.
EDWIN H. CASSELS. (Counsel.)
EDWIN H. CASSELS,
209 South LaSalle St.,
Chicago, Illinois.
ANDREW L. CAMPBELL. (Counsel.)
ANDREW L. CAMPBELL,
105 South LaSalle St.,
Chicago, Illinois.

[22] State of California,
County of San Francisco,—ss.

William R. Thorsen, being first duly sworn, on oath deposes and says that he is the petitioner named in the foregoing petition; that he has read said petition and that all the matters and things

therein stated are true and correct to the best of his knowledge, information and belief.

WILLIAM R. THORSEN.

WILLIAM R. THORSEN.

Subscribed and sworn to before me this 27th day of April, 1928.

[Seal] LEONTINE E. DENSON,

Notary Public in and for the City and County of San Francisco, State of California.

My commission expires Dec. 3, 1931.

[23] EXHIBIT "A."

TREASURY DEPARTMENT,
Washington.
Office of
Commissioner of Internal Revenue.

Address Reply to
Commissioner of Internal Revenue
and Refer to
IT:CR:G-4-60D.
G. C.

March 6, 1928.

Mr. William R. Thorsen,
1107 First National Bank Building,
San Francisco, California.

Sir:

In accordance with Seetion 274 of the Revenue Act of 1926 you are advised that the determination of your tax liability for the year 1923 discloses a deficiency of $36,720.96 as shown in the attached statement.

The section of the law above mentioned allows you an appeal to the United States Board of Tax Appeals within sixty days from the date of the mailing of this letter. However, if you acquiesce in this determination, you are requested to execute the enclosed Form A and forward it to the Commissioner of Internal Revenue, Washington, D. C., for the attention of IT:C:P-7.

Respectfully,

D. H. BLAIR,
Commissioner.

By (Signed) C. B. ALLEN,
Deputy Commissioner.

Enclosures:

Statement.
Form A.
Form 882.
Schedules 1 and 2.

Form 7928—Jan. 1928. mer-3.
(461M)
[24] IT:CR:G-4-60D.
GC.

Exhibit "A"—Cont'd.

STATEMENT OF RETURNS EXAMINED
and
RESULTING TAX LIABILITY.

Return Examined.

Taxpayer	Year.	Form.	Date Filed.
William R. Thorsen, San Francisco, California	1923	1040	January 24, 1924

Tax Liability.

Taxpayer	Year.	Deficiency in Tax.
William R. Thorsen, San Francisco, California	1923	$36,720.96

The adjustments shown in the accompanying Schedules 1 and 2, disclosing this deficiency in tax have been made on the basis of facts and data now before the Unit in connection with a Revenue Agent's report dated March 25, 1927.

The change in the allocation of dividends set out in office letter dated November 17, 1927, is due to the reallocation being made in accordance with the decisions of the United States Supreme Court in the Routzehn vs. Mason Case.

Reference is made to your contention as set out in your briefs dated January 14, 1928 and February 10, 1928 and the conference held in this office January 20, 1928 that the operating losses of the corporation during its fiscal years ended February 28, 1915 and 1916 should operate to reduce the surplus accumulated subsequent to February 28, 1916 available for taxable dividends. Careful consideration has been given to the arguments but it is held that all of the surplus earned subsequent to February 28, 1916 was available for taxable dividends.

mer–3.

[25] IT:CR:G-4-60D.

Exhibit "A" Cont'd.

-2-

GC.

Statement—continued.

In re: Mr. William R. Thorsen.

A consent extending the period to December 31, 1928, during which assessment may be made is on file.

Payment of the deficiency in tax should not be made until a bill is received from the Collector of Internal Revenue for your district and remittance should then be made to him.

A carbon copy of this letter is being mailed to Mr. Andrew L. Campbell, Chicago, Illinois, in accordance with your power of attorney running to him which is on file in this office.

mer-3.

Exhibit "A"—Cont'd.

-1-

[26] William R. Thorsen.

Year ended December 31, 1923.

Schedule 1.

Net Income reported on return	$189,032.72
Net Income adjusted	287,174.61
Additions	$ 98,141.89

Additions:

(a)	Decrease in partnership loss	$ 1,327.99

(b) Decrease in donations $ 120.00
(c) Increase in Taxable Dividends 96,693.90

Total additions as above ...$98,141.89

Explanation of Changes Made.

(a) The changes in the partnership income were explained in detail in the Revenue Agent's report on the partnership, Petrolia Oil Company, dated March 25, 1927.

(b) This item represents a contribution to the Anti-Saloon League which does not come within the purview of Section 214(a)11 of the Revenue Act of 1921.

(c) Taxable dividends from West Side Lumber Company:

Corrected $278,505.90
Reported on return 181,812.00

Addition .....$ 96,693.90

Of the total dividends received by you during this year 25.05% have been allocated as taxable. Since you received $1,111,800.00 the amount taxable on your return is $278,505.90.

mer–3.

[27] William R. Thorsen.

Exhibit "A"—Cont'd.

-2-

Year ended December 31, 1923.

Schedule 2.

Net Income adjusted		$287,174.61
Less: Dividends		316,661.42
Income subject to normal tax		None
Surtax on $287,174.61		$114,547.30
Less: 25% reduction under the Revenue Act of 1924		28,636.82
Tax Liability		$ 85,910.48
Tax previously assessed	$65,586.03	
Less: 25% reduction under the Revenue Act of 1924	16,396.51	
		49,189.52
Deficiency in tax		$36,720.96

[28] Filed Jul. 2, 1928. United States Board of Tax Appeals.

United States Board of Tax Appeals.

DOCKET No. 38,095.

WILLIAM R. THORSEN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

ANSWER.

Comes now the Commissioner of Internal Revenue, by his attorney, C. M. Charest, General Counsel, Bureau of Internal Revenue, and for answer to the petition of this taxpayer, admits and denies as follows:

1. Admits the allegations contained in Paragraph 1 of the petition.

2. Admits the allegations contained in Paragraph 2 of the petition.

3. Admits the allegations contained in Paragraph 3 of the petition.

4. Denies the allegations of error contained in subdivisions I to IV, inclusive, of Paragraph 4 of the petition.

5. (a) Admits that the petitioner filed his return for the year 1923 on or about January 24, 1924, in which he reported taxable income of $189,032.72. Denies each and every other allegation of fact contained in subdivision (a) of Paragraph 5 of the petition.

(b) Denies the allegations of fact contained in subdivision (b) of Paragraph 5 of the petition.

(c) Admits that the West Side Lumber Company is a California Corporation. For want of information denies each and every other allegation of fact contained in subdivision (c) of Paragraph 5 of the petition.

(d) Admits that in April, 1923, the West Side Lumber Company paid a dividend of $5,100,000 or $340 a share. Denies each and every other allegation of fact contained in subdivision (d) of Paragraph 5 of the petition.

[29] (e) Admits that the petitioner owns 3,270 shares of the capital stock of the West Side Lumber Company. For want of information denies each and every other allegation of fact contained in subdivision (e) of Paragraph 5 of the petition.

(f) Admits that in April, 1923, petitioner received in such distribution the sum of $1,111,800. Denies each and every other allegation of fact contained in subdivision (f) of Paragraph 5 of the petition.

(g) For want of information denies the allegations of fact contained in subdivision (g) of Paragraph 5 of the petition.

(h), (i), (j), (k). Denies the allegations of fact contained in subdivisions (h), (i), (j) and (k) of Paragraph 5 of the petition.

Denies generally and specifically each and every allegation of error and of fact contained in the taxpayer's petition not hereinbefore admitted, qualified or denied.

WHEREFORE, it is prayed that the taxpayer's appeal be denied.

(Signed) C. M. CHAREST,
General Counsel,
Bureau of Internal Revenue.

Of Counsel:
A. H. FAST,
Special Attorney,
Bureau of Internal Revenue.

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[30] Filed at Hearing Oct. 30, 1930. U. S. Board of Tax Appeals. Div. 4. Docket 38,095.

United States Board of Tax Appeals.

DOCKET No. 38,095.

WILLIAM R. THORSEN,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

MEMORANDUM OF FACTS.

It is hereby stipulated and agreed by and between the parties hereto, by their respective attorneys, that, for the purpose of this proceeding, the following facts may be accepted as true:

1.

The items of gross income, the deductions therefrom, and the net income shown in petitioner's 1923 return were as follows:

Gross Income.

Salaries received		$ 6,000.00
Interest received		4,267.38
Dividends received		219,967.52
		230,234.90

Deductions.

Partnership losses	$10,358.92	
Loss on sale of securities	19,849.01	
Interest paid	2,371.37	
Taxes paid	862.88	
Contributions	7,610.00	
Expenses	150.00	
		41,202.18
Net income shown in petitioner's 1923 return		$189,032.72

[31] 2.

The item of dividends amounting to $219,967.52 included in gross income in the petitioner's 1923 return consisted of—

Dividends received from the West Side Lumber Company on or about February 12, 1923, amounting to $10 a share on 3,270 shares, or	$32,700.00
Dividends received from the West Side Lumber Company on or about April 14, 1923, amounting to $340 a share on 3,270 shares, or $1,111,800, of which the petitioner reported as	

taxable income an amount equal to $55.60 a share on 3,270 shares, or	$181,812.00
Dividends received from other corporations	5,455.52
Total taxable dividends shown in petitioner's 1923 tax return.....	$219,967.52

3.

The determination of tax set forth in the Commissioner's notice of deficiency was arrived at by the computations shown in Exhibit "A" attached to the petition which is a true and correct copy of the Commissioner's letter dated March 6, 1928.

4

The computation by which the Commissioner determined that the the dividend of $340 a share paid by the West Side Lumber Company on April 14, 1923, was 25.05% taxable is set forth in a letter from the Commissioner dated January 6, 1928, in words and figures as follows:

[32] 4. (Continued)

TREASURY DEPARTMENT,
Washington.

IT:CR:G-4.
GC.

Jan. 6, 1928.

Mr. William R. Thorsen,
1107 First National Bank Building,
San Francisco, California.

Sir,

Reference is made to your brief dated November

30, 1927, in which you requested the computation of taxable dividends received by you from the West Side Lumber Company during the calendar year 1923 as shown in office letter dated November 17, 1927.

The allocation shown in office letter dated November 17, 1927, has been revised to the following as explained in office letter dated December 15, 1927:

Date paid	Taxable	Non-taxable
February 12, 1923	100%)	
	) Average	25.05%
April 14, 1923	22.85%)	77.15%

In accordance with the authority contained in a telegram from the West Side Lumber Company dated December 1, 1927, the following information is submitted:

Undistributed earnings accumulated subsequent to March 1, 1913, available for dividends February 28, 1922		$859,011.46
Earnings for the fiscal year ended February 28, 1923, available for dividends		718,858.29
		1,577,869.75
Dividends paid—		
September 15, 1922	$150,000.00	
December 18, 1922	150,000.00	
February 12, 1923	150,000.00	
		450,000.00

Undistributed earnings accumulated subsequent to March 1, 1913, available for dividends March 1, 1923	$1,127,869.75
Earnings for the fiscal year ended February 29, 1924, up to April 14, 1923 (44/366 of $311,209.54 total for year)	37,413.17
Total earnings accumulated subsequent to March 1, 1913, available for dividends April 14, 1923	1,165,282.92

[33] 4. (Continued)

Brought forward	$1,165,282.92
Dividends paid April 14, 1923	5,100,000.00
Amount paid April 14, 1923, out of earnings not accumulated subsequent to March 1, 1913 (non-taxable)	$3,934,717.08

A carbon copy of this letter has been mailed to Mr. Andrew L. Campbell, Chicago, Illinois, in accordance with your power of attorney running to him which is on file in this office.

Respectfully,

C. B. ALLEN,
Deputy Commissioner,
By (Signed) H. G. NICHOLS,
Chief of Section.

5.

The respondent concedes that the computation shown in letters dated January 6, 1928, and March 6, 1928, should be revised to show that the dividend

of $340 a share paid by the West Side Lumber Company on April 14, 1923, was 22.75% taxable instead of 25.05% taxable, determined as follows:

Statement of West Side Lumber Company Surplus Account March 1, 1913, to April 14, 1923.

Surplus March 1, 1913		$4,332,684.78
Add:		
Profit for year ended February 28, 1914		4,594.62
		4,337,289.40
Deduct:		
Loss for year ended February 28, 1915	$193,139.67	
Loss for year ended February 29, 1916	211,707.32	
		404,846.99
Surplus February 29, 1916, carried forward		$3,932,442.41

[34] 5. (Continued.)

Surplus February 29, 1916, brought forward.....	$3,932,442.41
Subsequent earnings:	
Year ended February 28, 1917.....	60,495.56
Year ended February 28, 1918.....	57,901.55
Year ended February 28, 1919.....	208,707.34
Year ended February 29, 1920.....	543,490.33
Year ended February 28, 1921.....	640,837.43
Year ended February 28, 1922.....	182,954.63
Year ended February 28, 1923.....	718,858.29
Period ended April 14, 1923 (44/366 of $311,209.54 total for year ended February 29, 1924).....	37,413.17
Total earnings March 1, 1916, to April 14, 1923...	$2,450,658.30

Less:		
Dividends paid:		
Year ended February 28, 1918	$ 90,000.00	
Year ended February 28, 1920	75,000.00	
Year ended February 28, 1921	375,000.00	
Year ended February 28, 1922	300,000.00	
Year ended February 28, 1923	450,000.00	
		1,290,000.00
Surplus March 1, 1916, to April 14, 1923 (22.75% of $5,100,000)		1,160.658.30
Dividend declared April 14, 1923		5,100,000.00
Amount to be paid out of surplus earned prior to March 1, 1913 (nontaxable)		$3,939,341.70

6.

The capital stock of the West Side Lumber Company during the period from March 1, 1913, to April 14, 1923, consisted of 15,000 shares having a par value of $100 each. The petitioner owned 3,270 shares of said capital stock during all of such period.

[35] 7.

The surplus of the West Side Lumber Company and it's earnings, losses, and dividends for the period from March 1, 1913, to April 14, 1923, were as follows:

Statement of West Side Lumber Company Surplus Account March 1, 1913, to April 14, 1923.

Surplus March 1, 1913		$4,332,684.78
Subsequent Earnings:		
Year ended February 28, 1914—Profit	$ 4,594.62	
Year ended February 28, 1915—Loss	(193,139.67)	
Year ended February 29, 1916—Loss	(211,707.32)	
Year ended February 28, 1917—Profit	60,495.56	
Year ended February 28, 1918—Profit	57,901.55	
Year ended February 28, 1919—Profit	208,737.34	
Year ended February 29, 1920—Profit	543,490.33	
Year ended February 28, 1921—Profit	640,837.43	
Year ended February 28, 1922—Profit	182,954.63	
Year ended February 28, 1923—Profit	718,858.29	
Period ended April 14, 1923—Profit (44/366 of $311,209.54 total for year ended February 29, 1924)	37,413.17	

		2,050,435.93
		6,383,120.71
Dividends paid:		
Year ended February 28, 1918	$ 90,000.00	
Year ended February 29, 1920	75,000.00	
Year ended February 28, 1921	375,000.00	
Year ended February 28, 1922	300,000.00	
September 15, 1922	150,000.00	
December 18, 1922	150,000.00	
February 12, 1923	150,000.00	
		1,290,000.00
Surplus April 14, 1923		$5,093,120.71

8.

On April 14, 1923, the West Side Lumber Company declared and paid a dividend of $5,100,000, or $340 a share on its 15,000 shares of capital stock, of which the petitioner received $1,111,800.

[36] The right is hereby reserved by both parties to prove any additional facts not inconsistent herewith.

WILLIAM R. THORSEN,
Petitioner.
By ANDREW L. CAMPBELL,
Attorney.
COMMISSIONER OF INTERNAL REVENUE,
Respondent.
By C. M. CHAREST,
Attorney.

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[37] 24 B. T. A. ——.

United States Board of Tax Appeals.

DOCKET Nos. 34,131, 38,095.

Promulgated October 27, 1931.

CHARLES J. CANFIELD,
Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,
Respondent.

WILLIAM R. THORSEN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Petitioners owned shares in a corporation having a capital stock of $1,500,000 and a surplus March 1, 1913, of $4,332,684.78. The corporation made a profit of $4,594.62 in the year ended February 28, 1914, and during the next two years, ended the last days of February, sustained a loss of $404,846.99, and in subsequent years and up to April 14, 1923, made profits amounting to $2,450,658.30, on which latter date a dividend of $5,100,000 was declared. Held, that the losses sustained, in the circumstances detailed in findings of fact, were properly considered made good from the then existing surplus and the profits thereafter constituted the most recently accumulated earnings or profits since March 1, 1913, and to the extent same were received by the petitioners (after deducting the amount of prior dividends, $1,290,000), the amounts are taxable income to them for 1923.

EDWIN H. CASSELS, Esq., and ANDREW L. CAMPBELL, C. P. A., for the Petitioners.

HAROLD ALLEN, Esq., and WILLIS R. LANSFORD, Esq., for the Respondent.

The Commissioner determined a deficiency in in-

come tax for 1923 of $9,243.66 in Docket No. 34,-131 and of $36,720.96 in Docket No. 38,095, the full amount of such deficiencies being in controversy.

A true copy.

[Seal] Teste: B. D. GAMBLE,
Clerk U. S. Board of Tax Appeals.

[38] These proceedings are consolidated for hearing, the issue, which is the same in each, being the proper method of computing accumulated earnings for the period subsequent to February 28, 1913, in determining taxable dividends received by petitioners. The facts are stipulated.

FINDINGS OF FACT.

The petitioners are individuals, Charles J. Canfield, residing and having his principal office in Chicago, Ill., and William R. Thornsen residing in Berkeley, Calif., with his principal office in San Francisco, Calif.

The West Side Lumber Company is a California corporation. During the period from March 1, 1913, to April 14, 1923, its capital stock consisted of 15,000 shares having a par value of $100 each, of which Charles J. Canfield owned 600 shares and William R. Thorsen 3,270 shares.

In addition to its original capital of $1,500,000, the West Side Lumber Company on March 1, 1913, had a surplus of $4,332,684.78.

On April 14, 1923, its surplus was $5,093,120.71, an increase of $760,435.93 over that of March 1, 1913.

The earnings and losses of the West Side Lumber Company after March 1, 1913, were as follows:

Year Ended.	Profits.	Losses.
February 28, 1914	$ 4,594.62	
February 28, 1915		$193,139.67
February 29, 1916		211,707.32
February 28, 1917	$ 60,495.56	
February 28, 1918	$ 57,901.55	
[39]		
February 28, 1919	208,737.34	
February 29, 1920	543,490.33	
February 28, 1921	640,837.43	
February 28, 1922	182,954.63	
February 28, 1923	718,858.29	
Period ended April 14, 1923 (44/366 of $311,209.54, total for year ended February 29, 1924)	37,413.17	
	$2,455,282.92	$404,846.99

The difference between the profits and losses of the several years set forth is $2,050,435.93.

The following dividends were paid by the West Side Lumber Company after February 28, 1913:

Year ended February 28, 1918	$ 90,000.00
Year ended February 29, 1920	75,000.00
Year ended February 28, 1921	375,000.00
Year ended February 28, 1922	300,000.00
September 15, 1922	150,000.00

September 18, 1922	$150,000.00
February 12, 1923	150,000.00
Total	$1,290,000.00

On April 14, 1923, the West Side Lumber Company declared and paid a dividend of $5,100,000, or $340 for each share of its stock, of which amount Charles J. Canfield received $204,000 on his 600 shares and William R. Thorsen received $1,111,800 on his 3,270 shares.

The petitioner, Charles J. Canfield, filed his income-tax return for the calendar year 1923 on March 14, 1924, and reported a net taxable income of $140,656.86. Included in his gross income in such return was an item of $6,000 returned as taxable income from the dividend received by him about February 12, 1923, from the West Side Lumber Company, and likewise included was another item in the amount of $33,360 returned as [40] dividend received about April 14, 1923, from said company and also dividends from other corporations in the amount of $7.

The petitioner, William R. Thorsen, filed his income-tax return for 1923 on January 24, 1924, and reported a net taxable income of $189,032.72. Included in his gross income in such return was an item of $32,700 returned as taxable income from the dividend received by him about February 12, 1923, from the West Side Lumber Company and there was also included therein an item of $181,812 as dividend received about April 14, 1923, from said company and dividends from other corporations in the amount of $5,455.52.

It is conceded by the Commissioner that his computations as set forth in his deficiency notices to the petitioners are incorrect in that the dividends paid them on April 14, 1923, were only 22.75 per cent taxable, instead of being 28.217 per cent taxable in the case of Charles J. Canfield and 25.05 per cent taxable in the case of William R. Thorsen, as formerly asserted.

The petitioners contend that said dividend distribution was only 14.91 per cent taxable and that each reported originally more taxable income than he should have returned.

OPINION.

SEAWELL.—The applicable law in the instant case is found in the Revenue Act of 1921 and reads as follows:

> Sec. 201. (a) That the term "dividend" when used in this title * * * means any distribution made by a corporation [41] to its shareholders or members, whether in cash or in other property, out of its earnings or profits accumulated since February 29, 1913, * * *.
>
> (b) For the purposes of this Act every distribution is made out of earnings or profits, and from the most recently accumulated earnings or profits, to the extent of such earnings or profits accumulated since February 28, 1913; but any earnings or profits accumulated or increase in value of property accrued prior to March 1, 1913, may be distributed exempt from the tax, after the earnings and profits accumulated since

February 28, 1913, have been distributed.

* * *

The petitioners contend that the difference between the total of the profits for the several years beginning with March 1, 1913, down to and including April 14, 1923, and the losses for the years in which losses were sustained in such period is the total "accumulated since February 28, 1913." That difference is shown to be $2,050,435.93. They insist that the surplus on February 28, 1913, of $4,332,684.78 represents earnings and profits accumulated prior to March 1, 1913, and being such are by the specific provisions of section 201 (b) of the Act exempt from the tax; that the surplus so created and existing can not be changed by any subsequent event; and that subsequent losses would have to be made good from future earnings or profits before there could be any earnings or profits "accumulated since February 28, 1913," which, when distributed as dividends, would be subject to tax. In other words, the petitioners do not accept the interpretation of the meaning of the word "accumulated" as used in the phrase "accumulated since February 28, 1913," as considered in O. D. 610, C. B. 3, p. 24, and A. R. M. 82, C. B. 3, p 36, and as likewise construed by the respondent and applied in the instant cases.

[42] The respondent in making his determination excludes from consideration for the period "since February 28, 1913," the losses (except to the extent of $4,594.62, profits for the year ending February 28, 1914), sustained in the year ended February 28, 1915, of $193,139.67, and in the year ended

February 29, 1916, of $211,707.32. To March 1, 1913, surplus of $4,332,684.78, he adds the profits for the year ended February 28, 1914, of $4,594.62, making a total of $4,337,279.40 from which he deducts the sum of the losses which occurred in the years ended February 28, 1915, and February 29, 1916, amounting to $404,846.99, still leaving a surplus of $3,932,432.41 on February 29, 1916.

After February 29, 1916, there are no further losses shown, only profits which from such date to April 14, 1923, the evidence indicates, amount to $2,450,688.30. From such amount respondent deducts the total of dividends, $1,290,000, paid prior to April 14, 1923, leaving taxable earnings or profits of $1,160,688.30 to be appropriated towards the payment of the April 14, 1923, dividend of $5,100,000. The difference between the $1,160,688.30 and the $5,100,000 declared and paid as a dividend April 14, 1923, is $3,939,311.70 and represents, so respondent contends, the portion of the dividend of April 14, 1923, paid out of the earnings or profits which constituted part of the surplus accumulated prior to March 1, 1913, and is tax exempt as dividends in the hands of the recipient stockholders.

Of the dividend of $5,100,000 paid April 14, 1923, the petitioner Canfield received $204,000 and the petitioner Thorsen, $1,111,800, and [43] if the respondent's method to tax computation is correct, each of the petitioners is taxable on 22.75 per cent of the dividend so received instead of on the larger percentage originally asserted by the respondent, but since conceded by the respondent to be incorrect.

In the year ended February 28, 1914, the company made a profit of $4,594.62 and if it had then, out of its total earnings or surplus, declared a dividend and made distribution even in excess of the $4,594,62, but less than the entire surplus, the whole dividend would have been taxable to the recipients thereof. The revenue law exempting from taxation dividends declared out of earnings accumulated prior to March 1, 1913, was not enacted until September 8, 1916. In Lynch vs. Hornby, 247 U. S. 339 (decided June 3, 1918), the court said:

> We repeat that under the 1913 Act dividends declared and paid in the ordinary course by a corporation to its stockholders after March 1, 1913, whether from current earnings or from a surplus accumulated prior to that date, were taxable as income to the stockholder.

No dividend was declared, however, out of the earnings for the year ending February 28, 1914, and it was accordingly proper for the corporation to add that sum, $4,594.62, to its accumulated surplus, bringing it to the sum of $4,337,279.40. When in the two succeeding years there were operating losses by the corporation charged, of course, against surplus, the surplus was reduced by the sum of the losses, $404,846.99, resulting in a new surplus on February 29, 1916, of $3,932,432.41.

The treatment to be accorded this new surplus and the earnings and profits thereafter accumulated by the corporation contains the matter in [44] controversy here. The petitioners contend that since

the new surplus is less than the surplus existing at March 1, 1913, all subsequent earnings and profits of the corporation should be added to this new surplus until it equals the surplus on hand at March 1, 1913, before dividends paid to stockholders are taxable.

In other words, the petitioners contend that they are not taxable on any dividend declared and paid at any time after March 1, 1913, although the corporation has had gains in that period, if for any cause, the corporation's surplus is less than what it was on that basic date; and they urge on us the construction of the clause of the statute "earnings or profits accumulated since February 28, 1913," that a period of all the years since March 1, 1913, should be considered together to ascertain whether there have been net accumulations for the whole period. It is elementary that the different parts of a statute are to be considered *in pari materia.* Certainly no part of a statute should be so interpreted as to annul any other part. When the statute provides that "every distribution is made * * * from the most recently accumulated earnings or profits, to the extent of such earnings or profits accumulated since February 28, 1913," there is implied that some earnings or profits may belong to a class accumulated more recently than others. If all the years since March 1, 1913, are to be taken together and additions and subtractions made to ascertain if earnings or profits have "accumulated" and the amount thereof during the period, then there would not seem to be much reason for ascertaining the nearness or remoteness

of such [45] earnings or profits. It could make no difference whether the distributions or dividends were from the most receit or most remote accumulations, since they all lie in one hodgepodge. Surely Congress had some reason for inserting in the statute the provision as to the most recent accumulations. All income taxing statutes under the Sixteenth Amendment are based on yearly periods, either calendar or fiscal years. Returns are so made out and gains and losses calculated so as to show profit or loss during the year, and for such a period it is immaterial which part of the gain is more recent or remote. It would seem singular if Congress did adopt the yearly period in taxation matters for all times and under all circumstances, except at the time of the enactment of the statute now under consideration and then only for part of the statute. It is more consonant with reason to suppose that Congress when it provided for "accumulations since February 28, 1913," had reference to accumulations in yearly periods. A contrary interpretation of the taxing law has been sought without success. In Edwards vs. Douglas, 269 U. S. 204, 217, the court said, in interpreting similar provisions of the Revenue Act of 1917, section 31 (b):

> * * * To accomplish the purpose of Congress it was necessary that the dividend be deemed to have been paid out of the available profits or earnings of the most recent year or years. Its intention so to provide was adequately expressed by the use of the phrase "most recently accumulated" in connection with the words "undivided profits or surplus." * * *

The Supreme Court in another case later said:

> * * * A taxpayer may be in receipt of net income in one year and not in another. The net result of the two years, [46] if combined in a single taxable period might still be a loss; but it has never been supposed that that fact would relieve him from a tax on the first, or that it affords any reason for postponing the assessment of the tax until the end of a lifetime, or for some other indefinite period, to ascertain more precisely whether the final outcome of the period, or of a given transaction, will be a gain or loss.
>
> Burnet vs. Sanford & Brooks Co., 282 U. S. 359.

The only losses of the West Side Lumber Company were for the years ending February 28, 1915, and February 29, 1916. The petitioners, who received dividends in 1923 from the corporation, contend in effect that the losses for those two years should be carried forward and deducted from gains in the years ending February 28, 1917, 1918, 1919 and 1920. The Revenue Act of 1918, section 204, permitted a net loss in one year to be carried to the preceding year to reduce the income in that year, and if in excess of such income for the preceding year, to have such excess carried forward to the succeeding year for a similar purpose as to the income in the succeeding year. But we know of no such provision of law applicable to the years here involved, and the Act of 1918 is not retroactive, or claimed by petitioners so to be. There was at the

time of these losses, which aggregate $404,846.99, no operating deficit of the corporation, but an undivided surplus, as before stated, of $4,337,279.40, all of which, except $4,594.62, was accumulated prior to March 1, 1913. The undivided surplus, therefore, was adequate to take care of the operating losses in the two years mentioned, without in any way impairing the capital of the corporation, which amounted to $1,500,000.

[47] The petitioners cite two recent court decisions which they insist sustain their contentions, viz., Leland vs. Commissioner, 50 Fed. (2d) 523, and Hadden vs. Commissioner, 49 Fed. (2d) 709. In the Leland case, first cited, the Board of Tax Appeals, 18 B. T. A. 795, is affirmed. In the opinion of the court it is said:

> Then again, as the Leland-Gifford Company had on hand, at the time the distributions were made, earnings or profits that had accumulated since 1913, we do not think that the provisions of section 201 (c) of the Revenue Act of 1921 and 1924 are applicable.

This case does not appear to be an authority for the petitioner. In the case of Hadden vs. Commissioner, *supra,* the corporation never had a surplus, but operating losses from its organization in 1904, in each year until April 30, 1917, at which time the net deficit was $833,862.92. The total losses between March 1, 1913, and April 30, 1917, were $329,549.22. From April 30, 1917, to December 20, 1917, by the sale of capital assets, it had a taxable profit of $405,-949.07. The court held that the operating losses or

carrying charges after March 1, 1913, should be deducted from the profits of December 20, 1917, before dividends declared and paid out of such taxable profits were taxable to the stockholders receiving the dividends. What the court would have held if, as in the case at bar, the corporation had had accumulated surplus and undivided profits sufficient to have absorbed all the losses before the profits by sale of the capital assets were realized, it is mere speculation to surmise; but the facts in that case are so different in material respects from those in [48] the instant case that we do not feel impelled to follow certain of the language used by the learned judge who delivered the opinion, even though it might be broad enough to include a situation comparable to that before us.

The respondent has conceded that his computation should be revised to show that the dividend paid by the West Side Lumber Company on April 14, 1923, was 22.75 per cent taxable instead of 28.217 per cent taxable, but insists upon the application in the instant cases of the principle adopted and maintained for many years by the Bureau of Internal Revenue and set forth in G. C. M. 3532, C. B. VII–1, 190, which position we think correct and we so expressed ourselves in Louise Glassell Shorb, 22 B. T. A. 644, 645, in which case the Commissioner had taken an opposite view. We are of the opinion that the principle so approved is also sustained in Blair vs. United States, 63 Ct. Cls. 193; certiorari denied 275 U. S. 546.

We are of the opinion that the deficiencies pro-

posed should be recomputed on the basis of corrected facts and in accordance with the application of the principle contended for by the respondent, which we hold to be correct.

Reviewed by the Board.

Judgment will be entered in each case under Rule 50.

[49] TRAMMELL, Dissenting.—It seems to me too clear for controversy that any surplus existing at February 28, 1913, has no connection whatever with what the accumulated surplus since that date is. What the majority opinion holds might be illustrated as follows: If a taxpayer had an earned surplus of $10,000 on February 28, 1913, and subsequent to that date had earnings in some years, and losses in others, and at the end of 1920 the total losses since February 28, 1913, equaled its total earnings since that date, with the result that at that time there were no earnings in fact accumulated since 1913, a distribution at the close of 1920 would be held to be out of the earnings or profits accumulated since February 28, 1913. In other words, the losses since February 28, 1913, are applied against the surplus existing on that date. Yet in the illustration given it is perfectly plain that the only surplus to be distributed was that existing on February 28, 1913. This, in my opinion, results in taxing the surplus existing on February 28, 1913, when distributed in dividends, contrary to the statute. In my opinion there can be no accumulated surplus since February 28, 1913,

unless the earning since that date exceed the losses since that date. These are the only factors to be considered. I see no occasion to apply losses since 1913 to surplus at that time in order to ascertain the accumulated earnings since February 28, 1913. This is quite different from the principle of determining earned surplus for invested capital purposes, where there is no requirement to determine accumulated surplus since a certain date, but only the question as to the total earned surplus existing in the taxable year or on hand when that year began. See Willcuts vs. Milton Dairy Co., 275 U. S. 215. [50] I believe the statute should be construed according to its plain language, that is, the distribution to be taxable must be out of earnings or profits accumulated since February 28, 1913, and that such amount should not be affected in any way by any surplus existing at that time.

The losses since February 28, 1913, should be taken from the profits since that date to determine the accumulated profits since that date.

I do not think the Shorb case in 22 B. T. A. 644, is authority for the majority decision. The corporation in that case was not organized until after March 1, 1913.

The prevailing opinion also relies on the case of Blair vs. United States, 63 Ct. Cls. 193 (A. F. T. R. 6552). In the case of J. L. Washburn, 16 B. T. A. 1091, the Board pointed out that it considered the Blair case to be unsound and declined to follow it.

In the case of Hadden vs. Commissioner, 49 Fed.

(2d) 709 (A. F. T. R., vol. 9, 1497), the Circuit Court of Appeals for the Second Circuit, said:

> The accumulated profits since March 1, 1913, must necessarily mean the net excess of all profits between March 1, 1913, and the date of distribution, less all losses sustained between the same dates * * *.

I think this view is correct and that it is erroneous to reduce the surplus on hand on February 28, 1913, by subsequent losses to determine the earnings and profits accumulated since that date.

MORRIS, MARQUETTE, SMITH, STERNHAGEN, LOVE, and McMAHON agree with this dissent.

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[51] United States Board of Tax Appeals,
Washington.

DOCKET No. 38,095.

WILLIAM R. THORSEN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

DECISION.

Pursuant to the findings of fact and opinion of the Board promulgated October 27, 1931, the respondent, on November 23, 1931, filed notice of settlement under Rule 50. Copy of said notice having been served on the petitioner and the peti-

tioner on December 16, 1931, having filed notice of acquiescence to the proposed settlement, it is

ORDERED and DECIDED: That there is a deficiency in tax for the year 1923 in the amount of $27,131.69.

(Signed) H. F. SEAWELL,
Member.

Entered Dec. 19, 1931.

A true copy.

[Seal] Teste: B. D. GAMBLE,
Clerk U. S. Board of Tax Appeals.

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[52] Filed April 16, 1932.

In the United States Circuit Court of Appeals for the Ninth Circuit.

B. T. A. No. 38,095.

WILLIAM R. THORSEN,

Petitioner,

vs.

DAVID BURNET, Commissioner of Internal Revenue,

Respondent.

PETITION FOR REVIEW.

Comes now William R. Thorsen, by Edwin H. Cassels and Barry Gilbert, his attorneys, and respectfully shows unto this court that:

A.

1. The petitioner is a citizen of the United States

and of the State of California, with his residence in Berkeley, California.

2. On or about the 24th day of January, 1924, the petitioner filed in the office of the Collector of Internal Revenue at San Francisco, California, his detailed income tax return for the calendar year 1923 and reported therein a net taxable income of $189,032.72 for said year 1923. Included in such return was an item of $181,812, returned as taxable income from a certain dividend received by him on or about April 14, 1923, from West Side Lumber Company, a California corporation.

[53] 3. West Side Lumber Company is a California corporation. During the period from March 1, 1913, to April 14, 1923, its capital stock consisted of 15,000 shares, having a par value of $100 each. The petitioner during all of such period owned 3,270 shares of said capital stock.

4. In addition to its said original capital of $1,500,000, West Side Lumber Company on March 1, 1913, had a surplus of $4,332,684.78 and the book value of its common stock was on that date $388.85 per share.

5. On April 14, 1923, its surplus was $5,093,120.71, an increase of $760,435.93 over that of March 1, 1913, so that the book value of the common stock on April 14, 1923, was $439.54 per share.

6. The earnings and losses of the company after March 1, 1913, were as follows:

Year Ending.	Profits.	Losses.
February 28, 1914	$ 4,594.62	
February 28, 1915		$133,139.67

February 29, 1916		$211,707.32
February 28, 1917	60,495.56	
February 28, 1918	57,901.55	
February 28, 1919	208,737.34	
February 29, 1920	543,490.33	
February 28, 1921	640,837.43	
February 28, 1922	182,954.63	
February 28, 1923	718,858.29	
March 1, 1923, to April 14, 1923 (44/336 of $311,209.54)	[illegible],413.17	
Total	$2,455,282.92	$404,846.99

The difference between the profits and losses of the several years set forth is $2,050,435.93.

[54] 7. The following dividends were paid by West Side Lumber Company after February 28, 1913:

Period.	Per Share.	Amount.
Year ended Feb. 28, 1918	$ 6	$ 90,000.00
Year ended Feb. 29, 1920	5	75,000.00
Year ended Feb. 28, 1921	25	375,000.00
Year ended Feb. 28, 1922	20	300,000.00
September 15, 1922	10	150,000.00
September 18, 1922	10	150,000.00
February 12, 1923	10	150,000.00
		$1,290,000.00

8. On April 14, 1923, West Side Lumber Company declared and paid a dividend of $5,100,000 or $340 a share on its 15,000 shares of capital stock. The petitioner received from this source

from his said 3,270 shares, the sum of $1,111,800. The issues in this case concern the taxable income due from the said William R. Thorsen with respect to this payment received by him.

9. The Commissioner of Internal Revenue, by his letter dated January 6, 1928, addressed to the petitioner, found that of the said $5,100,00 paid by the said dividend of West Side Lumber Company of April 14, 1923, $3,934,717.08 was paid out of surplus earned prior to March 1, 1913, and that the balance thereof, or $1,165,282.92, was paid out of the earnings of such company accumulated after February 28, 1913. This latter amount is 22.85% of the dividend paid on April 14, 1923. The Commissioner in such letter declared that such 22.85% of the dividend of April 14, 1923, represented taxable income to the petitioner under the provisions of Section 201 of the Internal Revenue Act of 1921.

[55] 10. Thereafter, on March 6, 1928, the Commissioner of Internal Revenue issued and mailed to the petitioner a deficiency letter from which the appeal to the Board of Tax Appeals hereinafter mentioned was prosecuted, and therein determined that the earnings accumulated after February 28, 1913, by West Side Lumber Company were approximately $1,277,550, or 25.05% of the dividend paid on April 14, 1923, and that the petitioner was therefore taxable under the provisions of Section 201 of the Internal Revenue Act of 1921 upon 25.05% of the dividend of $340 per share, or $278,505.90, received with respect to his said 3,270 shares.

11. In his said income tax return for the said calendar year of 1923, the petitioner had reported as taxable income the amount of $55.60 per share under his interpretation of Section 201 of said Internal Revenue Act of 1921. The said sum of $278,505.90 arrived at by the said Commissioner amounted to $85.17 per share. The issues thus presented between the Commissioner and this petitioner as a result of said deficiency letter were as to whether or not the difference between these two sums per share, on each of said 3,270 shares, or $29.57 per share, constituted taxable income to the petitioner for the year 1923.

12. Thereafter, the petitioner appealed from said determination of said Commissioner to the United States Board of Tax Appeals (Docket No. 38,095). The said Commissioner duly appeared therein and filed a stipulation [56] that his prior computations set forth in said letters of January 6, 1928, and March 6, 1928, were incorrect and that the said dividend of $340 per share paid by West Side Lumber Company on April 14, 1923, to this petitioner, with respect to each of his said 3,270 shares, was not to exceed 22.75% taxable, or at the rate of $77.35 per share or a total of $252,934.50.

13. Thereafter, the appeal of the petitioner was duly heard by said Board of Tax Appeals, which, on, to wit, the 27th day of October, 1931, promulgated its findings of fact and opinion in said proceeding and therein found and gave its opinion (eight members of said Board concurring therein, and seven members of said Board dissenting there-

from) that said dividend of $340 per share paid by West Side Lumber Company to this petitioner on April 14, 1923, with respect to each of his said 3,270 shares was 22.75% taxable.

14. The Board ordered that judgment be entered in said case under Rule 50 of said Board of Tax Appeals and pursuant thereto an order was subsequently entered finding that the total tax due from this petitioner for said year 1923 was $76,321.21, of which $49,189.52 had been previously assessed, leaving a balance of $27,131.69 for which judgment was entered by said Board under said Rule 50.

15. This petitioner claims that:

(a) This case is governed by Section 201 of the Internal Revenue Act of 1921.

[57] (b) West Side Lumber Company was entitled thereunder to distribute tax free all earnings and profits accumulated or increase in value in property accrued prior to March 1, 1913. Such earnings or profits were a sum equivalent to its surplus on February 28, 1913, namely, $4,332,684.78, and this sum was therefore distributable exempt from tax.

(c) The "earnings and profits" of West Side Lumber Company for the period March 1, 1913, to April 14, 1923, inclusive, were the difference between the total profits of the parts of such period in which profits were made ($2,455,282.92), and the total losses for the parts of such period in which losses were sustained ($404,846.99), namely, $2,050,435.93.

These net earnings so computed were the "earnings and profits" of West Side Lumber Company, "accumulated since February 28, 1913," within the meaning of Section 201 of the Internal Revenue Act of 1921.

(d) $1,290,000 of this amount having been distributed as dividends prior to April 14, 1923, the remainder of such amount, or $760,435.93, was distributed by West Side Lumber Company on April 14, 1923, under its dividend declaration of $340 per share, and having been "accumulated since February 28, 1913," was taxable income to [58] the several recipients thereof to the extent received by each.

(e) This sum of $760,435.93 was 14.91% of the total distribution of $15,100,000 ($340 per share) made April 14, 1923, by West Side Lumber Company, and therefore such distribution of $340 per share was 14.91%, or $50.694 per share, taxable to the several recipients within the meaning of Section 201 of the Internal Revenue Act of 1921.

(f) The "earnings and profits accumulated since February 28, 1913," having been thus distributed, the balance of the distribution made by the dividend of $340 per share on April 14, 1923, was free from tax in the hands of the recipients thereof under the provisions of Section 201 of the Internal Revenue Act of 1921.

(g) The taxable portion of the dividend of April 14, 1923, received by the petitioner from West Side Lumber Company was only 14.91% thereof, or approximately $165,769.38, which is

$16,042.62 less than was actually returned by him in his income tax return for 1923.

(h) There was no deficiency of tax as to 1923 on the part of the petitioner.

(i) There was no deficiency in tax for the year 1923. Instead, the petitioner paid for that year a tax of $49,189.52, whereas the proper [59] amount of his tax for that year was $43,826. He thus overpaid the sum of $5,363.52, which he is now entitled to have refunded to him.

16. The facts upon which the petitioner relies are those facts that are set out *in extenso* in the findings of fact of said Board of Tax Appeals promulgated on October 27, 1931, which are hereby by reference incorporated in and made a part of this petition with as full force and effect as though set forth *in haec verba* herein. The statements hereinbefore made are also relied upon and are in form a restatement of the findings of fact of the Board of Tax Appeals.

17. Briefly, the nature of this controversy is the question as to the meaning of Section 201 of the Internal Revenue Act of 1921 and in particular as to whether or not losses sustained in specific years following February 28, 1913, are to be deducted from profits gained in other years of such periods since February 28, 1913, in determining the "earnings and profits accumulated since February 28, 1913."

B.

The petitioner hereby assigns the following er-

rors with respect to the decision of said Board of Tax Appeals.

1. That said Board erred in finding that the dividend paid by West Side Lumber Company on April 14, 1923, was 22.75% taxable upon the 3,270 shares of its capital stock held by the petitioner, under the provisions of Section 201 of the Revenue Act of 1921.

[60] 2. That said Board erred in not finding that the dividend paid by West Side Lumber Company on April 14, 1923, was only 14.91% taxable upon the 3,270 shares of its capital stock held by the petitioner, under the provisions of Section 201 of the Revenue Act of 1921.

3. That said Board erred in failing to deduct the losses of $193,139.67 and $211,707.32 for the years ending February 28, 1915, and February 29, 1916, respectively, of West Side Lumber Company in computing the earnings and profits of that company accumulated since February 28, 1913.

4. That said Board erred in so interpreting Section 201 of the Internal Revenue Act of 1921 as to require the exclusion of the losses of $193,139.67 and $211,707.32 for the years ending February 28, 1915, and February 29, 1916, respectively, of West Side Lumber Company in computing the earnings and profits of that company accumulated since February 28, 1913.

5. That said Board erred in not finding that the entire surplus of West Side Lumber Company of $4,332,684.78 on March 1, 1913, was distributable

by it to its stockholders without tax to such stockholders.

6. That said Board erred in finding that only 77.25% of the dividend paid by West Side Lumber Company on April 14, 1923, was paid out of surplus accumulated by that company prior to March 1, 1913.

7. That said Board erred in not finding that the petitioner reported in his income tax return for the calendar year of 1923 all of his taxable income for that year.

[61] 8. That said Board erred in not finding that the petitioner included in his income tax return as taxable income for the calendar year 1923, $16,042.62 more of taxable dividends than he actually received during that year.

9. That said Board erred in not finding that the total earnings and profits of West Side Lumber Company accumulated since February 28, 1913, within the meaning of Section 201 of the Internal Revenue Act of 1921 were $2,050,435.93.

10. That said Board erred in not finding that only $760,435.93 of the distribution made by West Side Lumber Company on April 14, 1923, under its dividend declaration of $340 per share was accumulated since February 28, 1913, and taxable as income to the several recipients thereof.

WHEREFORE, this petitioner respectfully prays that the said decision and order of the Board of Tax Appeals may be reviewed by the Circuit Court of Appeals for the Ninth Circuit as by statute provided; that the said decision and order of

the Board of Tax Appeals be reversed with a finding that there is no deficiency in the amount of income tax paid by the petitioner for the year 1923; that the petitioner's tax for 1923 be properly recomputed; and that judgment be entered in favor of the petitioner for the excess heretofore paid by him beyond such proper tax.

WILLIAM R. THORSEN.
By EDWIN H. CASSELS,
BARRY GILBERT,
His Attorneys.

[62] State of California,
County of San Francisco,—ss.

William R. Thorsen, being first duly sworn, on oath deposes and says that he is the petitioner herein; that he has read the foregoing petition for review of the decision of the United States Board of Tax Appeals, and that all the facts therein stated are true and correct.

WILLIAM R. THORSEN.

Subscribed and sworn to before me this 29th day of March, A. D. 1932.

[Seal] LEONTINE E. DENSON,
Notary Public in and for San Francisco County, California.

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[63] Filed Apr. 16, 1932. United States Board of Tax Appeals.

Received Apr. 16, 1932. U. S. Board of Tax Appeals.

In the United States Circuit Court of Appeals for the Ninth Circuit.

No. 38,095.

WILLIAM R. THORSEN,

Petitioner,

vs.

DAVID BURNET, Commissioner of Internal Revenue,

Respondent.

PRAECIPE FOR TRANSCRIPT OF RECORD.

To the Clerk of the Board of Tax Appeals:

You will please prepare the record in the above-entitled proceeding, which is an appeal from a decision of the Board of Tax Appeals promulgated October 27, 1931, in the proceeding entitled "William R. Thorsen, Petitioner, v. Commissioner of Internal Revenue, Respondent, Docket 38,095," and transmit and deliver to the Clerk of the United States Circuit Court of Appeals for the Ninth Circuit, sitting at San Francisco, California, duly certified copies of the following documents:

1. All docket entries of proceedings before the Board of Tax Appeals in said proceeding.

2. Pleadings therein before the Board of Tax Appeals.

3. Findings of fact, opinion and decision therein of the Board of Tax Appeals.

[64] 4. Petition for review of said decision.
5. The stipulation of facts entered into by the petitioner and the respondent in said proceeding.

Respectfully,
EDWIN H. CASSELS,
BARRY GILBERT,
Attorneys for William R. Thorsen.

DOCKET No. 38,095.

WILLIAM R. THORSEN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

CERTIFICATE OF CLERK U. S. BOARD OF TAX APPEALS TO TRANSCRIPT OF RECORD.

I, B. D. Gamble, Clerk of the U. S. Board of Tax Appeals, do hereby certify that the foregoing pages 1 to 64, inclusive, contain and are a true copy of the transcript of record, papers and proceedings on file and of record in my office as called for by the praecipe in the appeal (or appeals) as above numbered and entitled.

IN TESTIMONY WHEREOF, I hereunto set my hand and affix the seal of the United States Board of Tax Appeals, at Washington, in the District of Columbia, this 29th day of April, A. D. 1932.

[Seal] B. D. GAMBLE,
Clerk.

[Endorsed]: No. 6838. United States Circuit Court of Appeals for the Ninth Circuit. William R. Thorsen, Petitioner, vs. Commissioner of Internal Revenue, Respondent. Transcript of Record. Upon Petition to Review an Order of the United States Board of Tax Appeals.

Filed May 9, 1932.

PAUL P. O'BRIEN,

Clerk of the United States Circuit Court of Appeals for the Ninth Circuit.

No. 6838

United States
Circuit Court of Appeals
For the Ninth Circuit

WILLIAM R. THORSEN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

Upon Petition to Review an Order of the United States Board of Tax Appeals.

PROCEEDINGS HAD IN THE UNITED STATES CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT.

At a stated term, to wit, the October Term, A. D. 1932, of the United States Circuit Court of Appeals for the Ninth Circuit, held in the Court Room thereof, in the City and County of San Francisco, in the State of California, on Wednesday, the eighth day of March, in the year of our Lord One Thousand Nine Hundred and Thirty-three.

Present: Honorable CURTIS D. WILBUR, Senior Circuit Judge, Presiding, Honorable WILLIAM H. SAWTELLE, Circuit Judge, Honorable JULIAN W. MACK, Circuit Judge.

[Title of Cause.]

ORDER OF SUBMISSION.

ORDERED above cause argued by Mr. Edwin H. Cassels, counsel for the petitioner, and by Mr. Hayner N. Larson, Special Assistant Attorney General, counsel for respondent, and submitted to the court for consideration and decision.

At a stated term, to wit, the October Term, A. D. 1932, of the United States Circuit Court of Appeals for the Ninth Circuit, held in the Court Room thereof, in the City and County of San Francisco, in the State of California, on Friday, the nineteenth day of May, in the year of our Lord One Thousand Nine Hundred and Thirty-three.

Present: Honorable WILLIAM H. SAWTELLE, Circuit Judge, Presiding, Honorable JULIAN W. MACK, Circuit Judge.

[Title of Cause.]

ORDER DIRECTING FILING OF OPINION AND FILING AND RECORDING OF JUDGMENT.

By direction of the Court, ORDERED that the typewritten opinion this day rendered by this court in above cause be forthwith filed by the clerk and that a judgment be filed and recorded in the minutes of this court in accordance with the opinion filed.

[Title of Court and Cause.]

OPINION OF UNITED STATES CIRCUIT COURT OF APPEALS.

Upon Petition to Review an Order of the United States Board of Tax Appeals.

Before: WILBUR, SAWTELLE and MACK, Circuit Judges.

MACK, Circuit Judge:

Review is sought of a decision of the Board of Tax Appeals, affirming, except with respect to a concededly erroneous computation, a determination by the Commissioner of Internal Revenue of the deficiency in petitioner's 1923 income taxes. Petitioner asserts that there was no deficiency.

The sole question is how much of the dividend received by petitioner as a stockholder in the West Side Lumber Co. on April 14, 1923, was a "distribution * * * out of * * * earnings or profits accumulated since February 28, 1913 * * *" and

therefore taxable; and how much a distribution out of "earnings or profits accumulated * * * prior to March 1, 1913" and therefore exempt. The case is governed by the Revenue Act of 1921; the applicable provisions are set out in the margin.

Petitioner's case before the Board was consolidated with that of Canfield, another stockholder in the Lumber Co., as to whom the same issue was presented. In so far as the decision affected Canfield, it was reversed in Canfield v. Commissioner, 62 F. (2d) 751 (C. C. A. 7, 1933). For the detailed facts with respect to the corporate financial situation, stipulated there as here, we refer to the statement in that case; pp. 751-52. We restate them briefly (giving round instead of exact figures).

On March 1, 1913, the company had a surplus of $4,400,000. Profits for the year ending February 28, 1914, were $4600. In each of the years ending February 28, 1915 and 1916, losses were suffered, together amounting to $400,000. Each year thereafter up to and including that in which the dividend in controversy was declared, the company made profits totalling in all $2,450,000.

Dividends amounting to $1,290,000 were declared between March 1, 1917, and February 12, 1923. The dividend of April 14, 1923, was in the sum of $5,100,000, of which petitioner, who held 3270 out of 15,000 shares, received $1,111,800.

The corporation has the right, under the statute, petitioner contends, to maintain the capital and earned, as well as paid in surplus that it had on

February 28, 1913, and, if they be impaired by subsequent losses, to restore them out of later profits, thereby leaving only the net profits, if any, of the period after February 28, 1913, as the "earnings or profits accumulated since February 28, 1913."

Respondent, on the other hand, contends that if the corporation instead of maintaining or distributing the earned surplus of February 28, 1913, prefers to risk its impairment by using it in the business, there is no statutory provision for applying subsequent profits to restoring that surplus to its original amount, if, meantime, losses shall have been incurred. If profits are earned after February 28, 1913, subsequent losses, concededly, would be chargeable against them, so far as they go; in this case, to the extent of $4600 earned in the year ending February 28, 1914. The losses, however, in excess of such profits, incurred before further

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"(a) * * * the term 'divided' when used in this title * * * means any distribution made by a corporation to its shareholders or members, * * * out of its earnings or profits accumulated since February 28, 1913, * * *

"(b) For the purposes of this Act every distribution is made out of earnings or profits, and from the most recently accumulated earnings or profits, to the extent of such earnings or profits accumulated since February 28, 1913; but any earnings or profits accumulated or increase in

profits are earned, are necessarily, respondent urges, paid out of and chargeable against the February 28, 1913, earned surplus, and are not held in suspense, to be paid out of later possible profits. If then profits are earned after that surplus shall have been so reduced, the entire amount thereof is asserted to be the "earnings or profits accumulated since February 28, 1913," and dividend distributions therefrom to be taxable.

14.91% or 22.75% of the April, 1923, dividends would be taxable as coming from these post February 28, 1913, accumulations, dependent upon which of these contentions is sound.

The Board of Tax Appeals in Walker v. Commissioner, 27 B. T. A. ....., stated to have been formulated before but announced after the Canfield decision in the 7th C. C. A., and later in Garrett v. Commissioner, ... B. T. A. ..... (Mar. 10, 1933), adopted the views expressed by the 7th C. C. A. in the Canfield case.

These decisions, and petitioner's contention, are based, in part, on the view that the Supreme Court has developed a general doctrine that accumulations prior to March 1, 1913, are to be treated as capital for all income tax purposes.[1] Clearly for some income tax purposes such accumulations are so treated. See, Lynch v. Turrish; Southern Pacific

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value of property accrued prior to March 1, 1913, may be distributed exempt from the tax, after the earnings and profits accumulated since February 28, 1913, have been distributed * * *." 42 Stat. 227.

Co. v. Lowe, both supra, note 1. But, on the day the Turrish and Southern Pacific cases were decided the Supreme Court in Lynch v. Hornby, 247 U. S. 339 (1918), recognized that for other purposes they need not be so treated. As the court said, in the Hornby case:

> "Of course we are dealing here with the ordinary stockholder receiving dividends declared in the ordinary way of business. Lynch v. Turrish and Southern Pacific Co. v. Lowe, rest upon their special facts and are plainly distinguishable." (p. 346.)

Further discussion of the Turrish and Southern Pacific cases, and the later cases, which add little if anything to the picture, will serve no useful purpose. It suffices to say that they establish no such doctrine as that for which petitioner contends.

Solution of the present question is not to be found in a formula thought to be developed in decisions addressed to entirely different situations. It must be sought in the specifically applicable

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[1]Cited as establishing this doctrine are: Old Colony R. R. v. Commissioner, 284 U. S. 552 (1932); Lucas v. Alexander, 279 U. S. 573 (1929); Eisner v. Macomber, 252 U. S. 189 (1920); Gulf Oil Corp. v. Lewellyn, 248 U. S. 71 (1918); Lynch v. Turrish, 247 U. S. 221 (1918); Southern Pacific Co. v. Lowe, 247 U. S. 330 (1918); Meischke-Smith v. Wardell, 286 F. 785 (C. C. A. 9, 1923); United States v. Guinzburg, 278 F. 363 (C. C. A. 2, 1921); Park v. Gilligan, 293 F. 129 (D. C. Ohio, 1921).

statutory provisions. The 1913 Act was held constitutional in providing for the tax on dividends paid out of surplus accumulated prior to March 1, 1913. Lynch v. Hornby, supra. The 1916 Revenue Act exempted such distribution; the court said in Lynch v. Hornby:

> "* * * as a concession to the equity of stockholders * * * in view of constitutional questions that had been raised in this case, in the companion case of Lynch v. Turrish, and perhaps in other cases." (p. 346.)

The later revenue acts have consistently preserved the exemption, even though, constitutionally, such dividends could be taxed.

We are here concerned with the extent of the exemption conferred by the Act of 1921. This act does not expressly convert the February 28, 1913, surplus into capital. It declares only that distributions out of accumulations since February 28, 1913, are taxable, that distributions out of accumulations prior thereto are exempted (see applicable provisions set out in margin, supra). In these provisions, there is no attempt to define capital for the purposes of the act. The statute specifies only that certain accumulations may be and certain others may not be distributed tax free. And the question is: What are included within these terms? We turn, therefore, to the phrase which describes the exemption:

> "* * * any earnings or profits accumulated * * * prior to March 1, 1913, may be distributed exempt from the tax, after the earnings and

profits since February 28, 1913, have been distributed."

Fairly construed, this is a privilege granted to a corporation to distribute by way of dividends, tax free as to its stockholders, any surplus that it may have on February 28, 1913. If, however, instead of distributing the surplus, the corporation, as in this case, subjects it to the hazards of the business, there is no provision for restoring, out of future normally taxable earnings, any part of the surplus that may thereby have been lost.

Petitioner emphasizes the clause defining taxable dividends instead of the exemption clause. He contends that the taxable "earnings or profits accumulated since February 28, 1913," must be deemed to mean net earnings or profits, that is, only the excess of profits earned over losses incurred after that date, and that therefore any distribution over and above such net profits must be deemed to be paid out of the tax exempt surplus of February 28, 1913. The argument ignores both bookkeeping and reality. The factual situation is that a part of the February 28, 1913, surplus was lost in the business in the following years. The distribution, of course, was not from losses but from the later earnings. Because Congress made distributions from the old surplus tax free, it cannot fairly be deemed to have intended that that surplus may be restored after it shall have been impaired by losses, and, in our judgment, the statutory language, fairly construed, admits of no such interpretation. Any such intent could have been

readily expressed by exempting "an amount equal to the February 28, 1913, surplus" or by taxing "the net profits earned after February 28, 1913."

The Treasury Department officials have consistently interpreted this and similar provisions in accordance with the views herein expressed.[2] While these interpretations do not have the force of Treasury Regulations, it may reasonably be assumed, as respondent urges, that if opposed to the legislative intent, they would have been changed in the 1924, 1926, 1928 or 1932 Acts. Cf. Murphy Oil Co. v. Burnet, 287 U. S. 299, 302-03 (1932), and cases cited; Mass. Mutual Life Ins. Co. v. United States, 288 U. S. 269, 273 (1933). Shorb v. Commissioner, 22 B. T. A. 644, 645, does not indicate, as petitioner contends, that the Treasury Department has been inconsistent. In that case the actual capital was impaired; there was no surplus on February 28, 1913. We express no opinion on such a case.

The decision in Blair v. United States, 63 C. Cls. 193 (1927), certiorari denied, 275 U. S. 546 (1927), appears to support the conclusion that we have reached. In Hadden v. Commissioner, 49 F. (2d) 709 (C. C. A. 2, 1931), there was stated to be a deficit, not a surplus, on March 1, 1913. Certain expressions in the court's opinion, though literally contrary to the views herein expressed, must be

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[2] A. R. M. 82, 3 Cumulative Bulletin 36 (1920); G. C. M. 3532, VII-1, Cumulative Bulletin 190 (1928).

deemed limited to the factual situation as there stated. If, as petitioner urges, a search of the record in other proceedings before the Board of Tax Appeals shows that there was in fact a surplus in the Hadden case, we may say with Judge Learned Hand (The San Simeon, 63 F. (2d) 798, 802 (C. C. A. 2, 1933)) that

> "* * * the practice of searching records and extracting as a part of the decision what the court did not mean to hold, may be useful as an academic exercise, but it is otherwise idle."

In Leland v. Commissioner, 50 F. (2d) 523 (C. C. A. 1, 1931), the surplus was paid in, not earned; the court assumed that such a paid in surplus, if diminished by losses, could be restored out of later profits, in holding that the losses of 1921, the year of incorporation, would be deductible from the profits of the succeeding years, in determining the taxability of a subsequent dividend distribution. There was, of course, on January 1, 1921, no earned surplus from which these losses could have been deducted. Unlike an earned surplus, a paid in surplus is, for these purposes, properly treated like capital.

The chronological order of profit and loss, as a basis for determining taxability, involves no absurdity, as argued by petitioner; it is not infrequently determinative in matters of taxation, as well as in other vital business affairs. An earned surplus on hand at the beginning of the year is subjected to the hazards of the business. If, despite the risk, losses are averted, that surplus has

remained intact and is distributable as a tax-free dividend after the profits, if any, shall have been paid out as taxable dividends. If, however, losses have been incurred, that surplus has been reduced to the extent thereof; it is no longer intact and available for such tax-free distribution.

The well settled practice in income tax matters is a sufficient answer to petitioner's challenge of the yearly instead of a quarterly or monthly basis for the determination of profit and loss. Cf. Burnet v. Sanford & Brooks Co., 282 U. S. 359 (1931).

Affirmed.

[Endorsed]: Opinion. Filed May 19, 1933. Paul P. O'Brien, Clerk.

United States Circuit Court of Appeals, for the Ninth Circuit.

No. 6838.

WILLIAM R. THORSEN,

Petitioner,

vs.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

JUDGMENT.

Upon petition to review an order of the United States Board of Tax Appeals, this cause came on to be heard on the transcript of the record from the United States Board of Tax Appeals and was

duly submitted. On consideration whereof, it is now here ordered and adjudged by this Court, that the order of the said Board of Tax Appeals in this cause be, and hereby is affirmed.

[Endorsed]: Judgment. Filed and entered May 19, 1933. Paul P. O'Brien, Clerk.

[Title of Court and Cause.]

APPLICATION FOR STAY OF MANDATE.

To the Honorable Curtis D. Wilbur, Presiding Judge, the Honorable William H. Sawtelle, Associate Judge, and the Honorable Francis A. Garrecht, Associate Judge, Judges of the Circuit Court of Appeals for the Ninth Circuit.

Your petitioner respectfully applies to this Honorable Court for a stay of mandate in the above entitled proceeding, and in support thereof and as grounds therefor respectfully alleges:

1. Petitioner purposes to apply to the Supreme Court of the United States for the issuance of a writ of certiorari to review the decision rendered by this court in the above entitled case on May 19, 1933.

2. The above entitled case and the case of Canfield v. Commissioner of Internal Revenue (No. 4761 of the United States Circuit Court for the Seventh Circuit) involve identical issues. The two proceedings were consolidated for hearing before

the United States Board of Tax Appeals and said Board rendered but one decision for the two cases. The United States Circuit Court of Appeals for the Seventh Circuit reversed the decision of the Board in Canfield v. Commissioner; while this Court has affirmed the identical decision of the Board in this proceeding. These adverse decisions cause a direct conflict which can be adjudicated only by the Supreme Court of the United States.

3. Petitioner is informed and believes that the Attorney General of the United States intends to forthwith apply to the Supreme Court of the United States for the issuance of certiorari to review the decision of the Circuit Court of Appeals for the Seventh Circuit in the proceeding entitled Charles J. Canfield v. Commissioner of Internal Revenue (No. 4761 in said Circuit).

4. Unless stay of mandate is granted in this proceeding petitioner will be deprived of any benefit of certiorari which may be granted in Canfield v. Commissioner of Internal Revenue, should the decision in that case by the United States Circuit Court of Appeals for the Seventh Circuit be affirmed by the United States Supreme Court.

It is respectfully submitted that, on the above allegation, stay of mandate should be ordered by this court.

EDWIN H. CASSELS,
ADOLPHUS E. GRAUPNER,
Attorneys for Petitioner.

[Endorsed]: Filed May 25, 1933. Paul P. O'Brien, Clerk.

[Title of Court and Cause.]

ORDER STAYING ISSUANCE OF MANDATE.

Upon application of Mr. Adolphus E. Graupner, counsel for the petitioner, and good cause therefor appearing, IT IS ORDERED that the issuance, under Rule 32, of the mandate of this Court in the above cause be, and hereby is stayed to and including July 1, 1933; and in the event the petition for a writ of certiorari to be made by the petitioner herein be docketed in the Clerk's office of the Supreme Court of the United States on or before said date, then the mandate of this Court is to be stayed until after the said Supreme Court passes upon the said petition.

CURTIS D. WILBUR,
United States Circuit Judge.

Dated, San Francisco, California,
May 25, 1933.

[Endorsed]: Filed May 25, 1933. Paul P. O'Brien, Clerk.

[Title of Court and Cause.]

CERTIFICATE OF CLERK U. S. CIRCUIT COURT OF APPEALS FOR THE NINTH CIRCUIT TO RECORD CERTIFIED UNDER RULE 38 OF THE REVISED RULES OF THE SUPREME COURT OF THE UNITED STATES.

I, Paul P. O'Brien, as Clerk of the United States Circuit Court of Appeals for the Ninth Circuit, do hereby certify the foregoing ninety-six (96) pages, numbered from and including 1 to and including 96, to be a full, true and correct copy of the entire record of the above-entitled case in the said Circuit Court of Appeals, made pursuant to request of counsel for the petitioner and certified under Rule 38 of the Revised Rules of the Supreme Court of the United States, as the originals thereof remain on file and appear of record in my office.

ATTEST my hand and the seal of the said the United States Circuit Court of Appeals for the Ninth Circuit, at the City of San Francisco, in the State of California, this 26th day of May, A. D. 1933.

[Seal] PAUL P. O'BRIEN, Clerk.

SUPREME COURT OF THE UNITED STATES

ORDER ALLOWING CERTIORARI—Filed October 9, 1933

The petition herein for a writ of certiorari to the United States Circuit Court of Appeals for the Ninth Circuit is granted. And it is further ordered that the duly certified copy of the transcript of the proceedings below which accompanied the petition shall be treated as though filed in response to such writ.

(4100)